Supreme Court, U.S.
FILED
NOV - 9 1993
OFFICE OF THE CLERK

No. 93-520

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

GEOFFREY, INC.,
Petitioner,
v.
SOUTH CAROLINA DEPARTMENT
OF REVENUE AND TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

PETITIONER'S REPLY BRIEF

WALTER HELLERSTEIN
Counsel of Record
PAUL H. FRANKEL
PRENTISS WILLSON, JR.
AMY L. SILVERSTEIN
CLARE M. RATHBONE
MORRISON & FOERSTER
345 California Street
San Francisco, CA 94104
(415) 677-7000

CARY H. HALL, JR.
WYCHE, BURGESS, FREEMAN
& PARHAM, P.A.
44 East Camperdown Way
P.O. Box 728
Greenville, SC 29602
Counsel for Petitioner

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

BEST AVAILABLE COPY

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

I. THE RECORD IS UNDISPUTED THAT GEOFFREY WAS NOT AN "ACTIVE FRANCHISOR" AND THAT GEOFFREY'S ONLY CONNECTIONS WITH SOUTH CAROLINA WERE THOSE OF A PASSIVE LICENSOR OF INTANGIBLE PROPERTY WHOSE LICENSEE CONDUCTED BUSINESS IN THE STATE 3

A. The Rights That Geoffrey Might Haxe Exercised—But in Fact Did Not Exercise—In South Carolina Under Its License Agreement With Toys "R" Us Are Irrelevant to South Carolina's Power to Subject Geoffrey to Tax 3

B. Labeling Geoffrey's Rights Under the License Agreement as a "Franchise" Adds Nothing to South Carolina's Constitutional Power to Tax Geoffrey 4

II. RESPONDENT'S ATTEMPTS TO BELITTLE THE SIGNIFICANT PRACTICAL IMPLICATIONS OF THIS CASE ARE BELIED BY THE RATIONALE OF THE DECISION BELOW, BY THE CONCERNS EXPRESSED BY *AMICI* SUPPORTING PETITIONER, AND BY RESPONDENT'S OWN ADMINISTRATIVE PRACTICE 5

III. THE COMMERCE AND DUE PROCESS QUESTIONS PRESENTED BY PETITIONER ARE SUBSTANTIAL, AND RESPONDENT'S CLAIMS TO THE CONTRARY ARE BASED ON MISCHARACTERIZATIONS OF THIS COURT'S PRECEDENTS 7

A. Not Only Did *Quill* Leave Open the Question Whether a Commerce Clause "Substantial Nexus" Requirement of Physical Presence Applies Outside the Sales and Use Tax Context, This Is the Ideal Case for Deciding That Question 7

TABLE OF CONTENTS—Continued

Page

B. Respondent's Contention That the Decision Below "Followed Established Precedent" Under the Due Process Clause Ignores the Division in the Court in *Asahi* Over the Question Presented by This Case 9

CONCLUSION 10

TABLE OF AUTHORITIES

Cases Page

AAMCO Transmissions, Inc. v. Taxation and Revenue Dep't, 600 P.2d 841 (N.M. App.), *cert. denied*, 598 P.2d 1165 (N.M. 1979) 8-9
American Dairy Queen Corp. v. Taxation and Revenue Dep't, 605 P.2d 251 (N.M. App. 1979) 8
Asahi Metal Indus. Co. v. Superior Court, 480 U.S. 102 (1987) 2, 9, 10
ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) 4
Baskin-Robbins Ice Cream Co. v. Revenue Div., 599 P.2d 1098 (N.M. App. 1979) 9
Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) 8
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 5
Curry v. McCanless, 307 U.S. 357 (1939) 8
F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982) 4
Goldberg v. Sweet, 488 U.S. 252 (1989) 8
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) 8
National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967) 8
Quill Corp. v. North Dakota, 112 S. Ct. 1904 (1992) 2, 5, 7, 8
Railway Express Agency, Inc. v. Virginia, 358 U.S. 434 (1959) 5
Shaffer v. Carter, 252 U.S. 37 (1920) 8
Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue, 483 U.S. 232 (1987) 8
Wheling Steel Corp. v. Fox, 298 U.S. 193 (1936) 8

Other Authorities

Black's Law Dictionary, 592 (5th ed. 1979) 5
South Carolina Dep't of Revenue and Taxation, *Information Letter #93-20*, Sept. 22, 1993, [S.C.] St. Tax Rptr. (CCH) ¶ 340-017 (1993) 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

No. 93-520

GEOFFREY, INC.,

Petitioner,

v.

SOUTH CAROLINA DEPARTMENT OF REVENUE AND TAXATION,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

---

PETITIONER'S REPLY BRIEF

The theoretical and practical significance of the question presented by Geoffrey in its petition—whether a licensor of intangible property is subject to tax wherever its licensee uses the property—cannot seriously be denied. It is therefore understandable that respondent's brief in opposition amounts largely to an effort to divert the Court's attention from this question. Thus respondent claims that the facts of this case do not squarely raise the question presented by the petition because Geoffrey is purportedly more than a passive licensor of intangible property used by a licensee in South Carolina. In this connection, respondent seizes on the state court's characteriza-

tion of Geoffrey as having a "franchise" (Pet. App. A at 5a) in South Carolina as the basis for its contention that Geoffrey operated in the state as an "active franchisor." Opp. at 8. In addition, respondent dismisses the relevance of the implications of the South Carolina court's decision for taxpayers other than Geoffrey because respondent apparently believes that these implications have no bearing on the certworthiness of this case.

Insofar as respondent seeks to address the legal issues raised by Geoffrey, respondent mischaracterizes the precedents on which it relies. Although the Court in *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992), never elaborated on the meaning of the Commerce Clause's "substantial nexus" requirement outside the context of sales and use taxation, respondent would nevertheless read that decision as resolving the "substantial nexus" question in this case. Without even acknowledging the deep division in this Court over the question whether knowledge that one's product may find its way into a state is, without more, a sufficient basis for asserting jurisdiction over a nonresident defendant under the Due Process Clause, *see Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102 (1987) (discussed in Pet. at 15-18), respondent contends that Geoffrey is subject to jurisdiction in South Carolina merely because it was "aware its trademarks could be used in South Carolina." Opp. at 17.

As we demonstrate below, none of these assertions, nor others that respondent advances in opposition to the petition, can withstand scrutiny.

I. THE RECORD IS UNDISPUTED THAT GEOFFREY WAS NOT AN "ACTIVE FRANCHISOR" AND THAT GEOFFREY'S ONLY CONNECTIONS WITH SOUTH CAROLINA WERE THOSE OF A PASSIVE LICENSOR OF INTANGIBLE PROPERTY WHOSE LICENSEE CONDUCTED BUSINESS IN THE STATE

A. The Rights That Geoffrey Might Have Exercised—But in Fact Did Not Exercise—In South Carolina Under Its License Agreement With Toys "R" Us Are Irrelevant to South Carolina's Power to Subject Geoffrey to Tax

Throughout its brief in opposition, respondent adverts to rights that Geoffrey possessed under its license agreement with Toys "R" Us in an effort to paint Geoffrey as an "active franchisor" (Opp. at 8) rather than as a passive owner of trademarks used in South Carolina by a licensee. Respondent observes, for example, that "Toys was allowed to . . . receive Geoffrey's 'merchandising skills, techniques and know-how in the operation of [Toys'] business.'" Opp. at 4 (quoting license agreement); that "the license agreement allows Geoffrey . . . to tell its licensee that it does not want the licensee to sell specified merchandise in South Carolina," *id.* at 4-5 (citing license agreement); and that Geoffrey has the authority "to approve what merchandise and services can be sold with its trademark," *id.* at 18 (citing license agreement), "to approve the advertising and sales promotion materials to be used with its trademark," *id.* (citing license agreement), and to "inspect the books and records of the licensee . . . ." *Id.* (citing license agreement).

What respondent fails to tell the Court, however, is that Geoffrey never exercised any of these rights in South Carolina, as the uncontradicted testimony of Louis Lipschitz, Geoffrey's Secretary, reveals:

> Q Mr. Stevens took you through the license agreement and the rights that Geoffrey has under—the

various rights Geoffrey has under that license agreement.

A That's correct.

Q Does Geoffrey now or has it ever exercised any of those rights in the State of South Carolina?

A No, sir.

R. 59.

Respondent's claim that Geoffrey was an "active franchisor" (Opp. at 8) is therefore based on the false premise that Geoffrey actually exercised the rights it had under the license agreement. The record is undisputed that Geoffrey's connections with South Carolina never exceeded those of a passive licensor of intangible property employed by a licensee in the state. South Carolina's jurisdiction to tax Geoffrey plainly must be predicated on what, if anything, Geoffrey actually did in South Carolina, not on what it might have done under the license agreement.[1]

B. Labeling Geoffrey's Rights Under the License Agreement as a "Franchise" Adds Nothing to South Carolina's Constitutional Power to Tax Geoffrey

In its effort to portray Geoffrey as more than a passive owner of trademarks used by a licensee in South Carolina, respondent relies on the state courts' conclusion that Geoffrey had a "franchise" in South Carolina. Opp. at 7-11. In respondent's view, the existence of such a "franchise" provides an independent predicate for the exercise of South Carolina's taxing power. But this Court has recognized, especially in recent years, that the constitutional restraints on state taxing power do not depend on

[1] *Cf. ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 320-29 (1982) (actual control, not potential for control, is the test for determining whether the requisite control exists to render two businesses unitary); *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354, 362-72 (1982) (same).

"magic words or labels." *Railway Express Agency, Inc. v. Virginia*, 358 U.S. 434, 441 (1959). Whether a tax is imposed on "the privilege of doing business" in a state or on the exercise of a "franchise" is irrelevant to the constitutional analysis. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); *Quill*, 112 S. Ct. at 1911-12. Rather, the pertinent question is whether, as a matter of substance, the taxpayer has the "substantial nexus" or "minimum contacts" with a state demanded by the Commerce and Due Process Clauses.

Moreover, seizing on the dictionary definition of a "franchise" quoted by the court below,[2] respondent leaps to the conclusion that Geoffrey is an "active franchisor" (Opp. at 8) conducting a "franchise business . . . in South Carolina," *id.* at 10, thereby conjuring up the image of a McDonald's or a Wendy's with active oversight of the franchisee by the franchisor. The suggestion is preposterous and totally ignores the factual record. *See supra* pp. 3-4.

II. RESPONDENT'S ATTEMPTS TO BELITTLE THE SIGNIFICANT PRACTICAL IMPLICATIONS OF THIS CASE ARE BELIED BY THE RATIONALE OF THE DECISION BELOW, BY THE CONCERNS EXPRESSED BY *AMICI* SUPPORTING PETITIONER, AND BY RESPONDENT'S OWN ADMINISTRATIVE PRACTICE

In an effort to downplay the significance of the decision below, respondent asserts that petitioner "provides no

[2] "In its simplest terms, a franchise is a license from the owner of a trademark or trade name permitting another to sell a product or service under that name or mark. More broadly stated, a 'franchise' has evolved into an elaborate agreement under which the franchisee undertakes to conduct a business or sell a product or service in accordance with methods and procedures prescribed by the franchisor, and the franchisor undertakes to assist the franchisee through advertising, promotion, and other advisory services." Pet. App. A at 5a-6a n.2 (quoting *Black's Law Dictionary* 592 (5th ed. 1979)).

analysis" (Opp. at 8) to justify the conclusion that " '[u]nder the court's ruling, whenever a person's intangible property is used by others, the person will be subject to tax wherever such property is used.' " Opp. at 6-7 (quoting Pet. at 20). Petitioner did not need to provide such analysis because, as petitioner pointed out in its petition, such analysis was provided by the court below.

The *court* declared that "the 'minimum connection' required by due process . . . is satisfied by the presence of Geoffrey's intangible property in this State." Pet. App. A at 5a. The *court* declared that "the presence of these intangibles is sufficient to sustain a tax." *Id.* at 5a-6a. The *court* declared that, under the Commerce Clause, "[t]he presence of intangible property *alone* is sufficient to establish nexus." *Id.* at 9a (emphasis supplied). And the *court* declared that "by licensing intangibles for use in this State and deriving income from their use here, Geoffrey has a 'substantial nexus' with South Carolina." *Id.* at 10a. Under this analysis, one can only wonder how respondent can harbor any doubt about petitioner's conclusion that "authors, television producers, software developers, banks merely holding securities, and athletes making endorsements are subject to . . . taxation under the ruling of the *Geoffrey* decision." Opp. at 7.

In any event, whatever question respondent may have about the enormous consequences of this case, it is plain that a broad cross-section of American industry is deeply concerned about the far-reaching implications of the decision below. The National Retail Federation, the Information Technology Association of America, the International Franchise Association, the Tax Executives Institute, the Committee on State Taxation, and the Ohio Chamber of Commerce have all filed *amicus* briefs registering their anxieties over the ramifications of the South Carolina court's decision and urging this Court to grant review of the case. The repercussions of the decision

below that are documented in these *amicus* briefs should dispel any doubt about the decision's national significance.

Finally, respondent's protestations that petitioner has inflated the importance of this case are belied by respondent's own administrative practice. Under respondent's "administrative practice" (Pet. App. B at 17a) any activity—whether tangible or intangible—that generates income in the state subjects the taxpayer to state tax liability. "For example, finance companies are taxed in South Carolina based on whether the borrower resides in this state." *Id.* Similarly, "[r]estaurant franchise companies that have no activity in the state except the presence of their franchise name from which they derive income are subject to tax in South Carolina." *Id.* Moreover, in late September the respondent announced that it was "reviewing this case further and its application to other intangible property." South Carolina Dep't of Revenue and Taxation, *Information Letter #93-20*, Sept. 22, 1993, reported in [S.C.] St. Tax Rptr. (CCH) ¶ 340-017 (1993). The implications of the sweeping conception of state tax jurisdiction embraced by the decision below are thus fueled by far more than "speculation on the outcome of untried hypothetical arrangements." Opp. at 7-8.

III. THE COMMERCE AND DUE PROCESS QUESTIONS PRESENTED BY PETITIONER ARE SUBSTANTIAL, AND RESPONDENT'S CLAIMS TO THE CONTRARY ARE BASED ON MISCHARACTERIZATIONS OF THIS COURT'S PRECEDENTS

A. Not Only Did *Quill* Leave Open the Question Whether a Commerce Clause "Substantial Nexus" Requirement of Physical Presence Applies Outside the Sales and Use Tax Context, This Is the Ideal Case for Deciding That Question

Respondent's contention that "*Quill* leaves no unanswered question of physical presence as a standard in an income tax" (Opp. at 15) context misreads this Court's

opinion in *Quill* and ignores its antecedents. The Court in *Quill* recognized that in its "review of other types of taxes" it had not "articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes," but rather had been "silen[t]" on the issue. *Quill*, 112 S. Ct. at 1914. There is therefore no basis for respondent's assertion that "[i]n the income tax area . . . there are . . . settled expectations . . . . that no physical presence is required" (Opp. at 15) for a state to establish taxing jurisdiction. In fact, as it observed in *Quill*, the Court has cited *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), with approval in cases involving other types of taxes. *Quill*, 112 S. Ct. at 1912 (citing *Goldberg v. Sweet*, 488 U.S. 252, 263 (1989) (telecommunications excise tax); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981) (severance tax); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 437 (1980) (corporate income tax)). The Court has not articulated a physical-presence rule in the income tax context because it has not had occasion to do so.[3]

---

[3] As noted in Geoffrey's petition, the Court has *never* upheld a state tax over Commerce Clause objections in the absence of physical presence by the taxpayer. Pet. at 11-12. Respondent nevertheless cites *Shaffer v. Carter*, 252 U.S. 37 (1920), *Curry v. McCanless*, 307 U.S. 357 (1939), *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936), and *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987) (Opp. at 9-10) for the proposition that "the conducting of an ongoing business in a state by means of an integral intangible establishes a substantial nexus with the state." Opp. at 9. But each of these cases involved taxpayers who had substantial physical presence in the taxing state. *Shaffer* (oil and gas leases); *Curry* (the estate of a domiciliary decedent and local trust companies); *Wheeling Steel* (corporate headquarters); *Tyler Pipe* (sales representatives). Hence these cases scarcely establish the proposition for which they are cited.

Respondent's invocation of three cases decided in the same year by the intermediate appellate court of a single state hardly strengthens its position. *See American Dairy Queen Corp. v. Taxation and Revenue Dep't*, 605 P.2d 251 (N.M. App. 1979); *AAMCO Trans-*

Accordingly, this case presents an ideal opportunity for the Court to decide whether physical presence is required for a state to impose an income tax and, if not, what comprises "substantial nexus" for state income tax purposes. Contrary to respondent's suggestion, this question *must* be resolved in the context of an out-of-state taxpayer with only an intangible presence in the state. If the out-of-state taxpayer had no presence in the state—tangible or intangible—then taxation would clearly be impermissible. If the out-of-state taxpayer had a physical presence in the state, then the Court would never reach the question whether physical presence is required to impose an income tax.

B. Respondent's Contention That the Decision Below "Followed Established Precedent" Under the Due Process Clause Ignores the Division in the Court in *Asahi* Over the Question Presented by This Case

In its petition, Geoffrey pointed out that the question whether a licensee's use of a trademark in a state confers jurisdiction to tax an out-of-state licensor raises a substantial due process issue in light of the deep divisions in this Court over an analogous issue presented in *Asahi*. Pet. at 14-19. Without even citing *Asahi*, respondent asserts that South Carolina's assertion of jurisdiction over Geoffrey meets due process strictures because "Geoffrey has purposefully directed activity toward South Carolina's economic market by consciously allowing and controlling the use of its trademarks in the State." Opp. at 18. In

---

missions, Inc. v. Taxation and Revenue Dep't, 600 P.2d 841 (N.M. App.), *cert. denied*, 598 P.2d 1165 (N.M. 1979); *Baskin-Robbins Ice Cream Co. v. Revenue Div.*, 599 P.2d 1098 (N.M. App. 1979). None of the cases meaningfully considered Commerce Clause requirements for establishing nexus or even cited *Bellas Hess*. Moreover, in the 14 years since those cases were decided, they had never been followed, relied on, or even cited (except once for an unrelated proposition) by any court, either in New Mexico or any other jurisdiction, until the South Carolina Supreme Court cited them in this case.

light of *Asahi*, however, it is highly questionable whether merely allowing trademarks to be exploited in South Carolina satisfies the "purposeful availment" component of this Court's "minimum contacts" doctrine. Pet. at 14-19. By failing even to address this point, respondent leaves petitioner's due process contention unanswered.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

WALTER HELLERSTEIN
Counsel of Record
PAUL H. FRANKEL
PRENTISS WILLSON, JR.
AMY L. SILVERSTEIN
CLARE M. RATHBONE
MORRISON & FOERSTER
345 California Street
San Francisco, CA 94104
(415) 677-7000

CARY H. HALL, JR.
WYCHE, BURGESS, FREEMAN
& PARHAM, P.A.
44 East Camperdown Way
P.O. Box 728
Greenville, SC 29602
Counsel for Petitioner